

# Scheme Advisory Board (SAB)

## Department for Levelling Up, Housing and Communities

### Local Government Pension Scheme (England and Wales): Next steps on investments

LGF Pensions Team, DLUHC  
2nd Floor  
Fry Building  
2 Marsham Street  
London SW1P 4DF

[LGpensions@levellingup.gov.uk](mailto:LGpensions@levellingup.gov.uk)

### Response to consultation

This response is submitted on behalf of the Local Government Pension Scheme Advisory Board (England and Wales) which is a body set up under Section 7 of the Public Service Pensions Act 2013 and The Local Government Pension Scheme Regulations 110-113.

The Board's purpose is to:

- Provide advice to the Secretary of State and to administering authorities on “the desirability of changes to the scheme” and “in relation to the effective and efficient administration and management” of the LGPS E&W (“the Scheme”)
- Provide a framework to encourage best practice, increase transparency and coordinate technical and standards issues across the sector

Membership of the Board includes equal number of voting members representing employers and employees. The Board is also supported by non-voting members and advisors.

There are around 18,000 employers participating in the Scheme and therefore there are representatives of some of the larger employer groups (further/higher education institutions and academy schools) on the Board and its sub-committees.

Secretariat services are provided by the Local Government Association and separate Advisory Boards have been established for the LGPS in Scotland and in Northern Ireland. They are outside the scope of this response.

This response has been compiled by the Board Secretariat in consultation with members of the Board and approved by the Board in correspondence.

Yours sincerely,



Cllr Roger Phillips  
Chair of the Board

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## Response to consultation questions

### Preliminary remarks

The Board welcomes this consultation, which provides much-needed clarity on the Government's future intent on investment policy. The Board will engage fully and positively with the Government, LGPS funds and pools to build as broad a consensus as possible on the way forward.

However, the long delay from when this consultation was first mooted (2019) and its publication now has led to a considerable degree of uncertainty and unhelpful speculation. There was an absence of engagement in that period which was not helpful to those trying to push forward and make progress towards further collaboration on the delivery of fund investment strategies. That uncertainty could have been mitigated by an active dialogue between departmental officials, the Board and those working at funds and pools about their experience of pooling. We hope for lessons to be drawn that whatever the outcome of this consultation there needs to be a much greater level of engagement moving forward. That should be on an open and ongoing basis so that policy thinking can be shared and even in future co-produced.

In terms of this particular consultation, the Board recognises that we need to start from where we now are and not revisit earlier arguments about the merits of pooling. We believe that the most important question is how the Scheme can move forward in the best way possible.

The Board supports greater transparency and reporting, indeed it has developed the first scheme-level annual reports and triennial valuation summaries. Perhaps because of its efforts to produce scheme-wide publication, the Board recognises that compliance with existing publication requirements contained in regulations and statutory guidance is not universal.

There may be some good reasons for that, in terms of the well-recognised staffing difficulties and burgeoning workload of LGPS officers. However, the Board believes that it is time to review the panoply of reports, statements and strategies that funds are asked to produce and rationalise these with an eye to their core purpose and intended audience. Once that has been done, and there is a shared view that the reporting burden is reasonable, it would be appropriate to consider what the best enforcement mechanism is to ensure that LGPS funds are meeting their reporting obligations.

It is also important for the Board to emphasise that in order to deliver on existing workstreams, as well as taking forward many of the necessary reporting and guidance changes suggested in the consultation, the Board's annual budget and resourcing level in the Secretariat team will need to increase. We hope that the Minister will appreciate that without additional resource, it will not be possible for the Board to deliver these additional asks.

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## Responses to specific questions

### **Question 1: Do you consider that there are alternative approaches, opportunities or barriers within LGPS administering authorities' or investment pools' structures that should be considered to support the delivery of excellent value for money and outstanding net performance?**

One barrier that the Department needs to address is the lack of evidence in the public domain that makes the case for their preferred model. The consultation refers to data supplied by the pools which has never been published and one research paper looking at international comparisons. Improving Scheme transparency has been a key principle for the Board, which is why we have established the Scheme-level Annual Report as well as the triennial Valuation report.

The Board believes that it would be easier to reconcile the differing views that exist if there were a wider evidence base to draw upon. There are always likely to be some who oppose pooling in principle but there will be some who may be persuadable if the case could be made in an independent, evidence-based manner.

Even for those who accept the basic premise of greater scale being needed, most would accept that the success of a pool in practice is built more on alignment of strategies and underlying approach to investment, rather than of total AUM. The one research paper quoted in the consultation also seems to recognise that.

The Board would therefore recommend that the Department should recognise that there also needs to be consideration of the number and size of partner funds who participate in a pool, as well as the total AUM. It seems plausible that there needs to be a manageable number of funds participating in order to effectively set a common direction and secure the benefits of a harmonised approach. If it is accepted that funds may legitimately have their own investment philosophy, then that needs to be respected and progress achieved by consent.

Of course, alignment of investment approaches requires building relationships of trust between partner funds and with the pool – which is why governance is key. Governance works best when partner funds are engaged and pro-active owners/members of pools and over time develop those relationships of trust.

Collaboration and trust cannot simply be mandated and that is why the Board believes that there is an ongoing role for both the Department and the Board to facilitate the development of those behaviours. That can be done both directly by engaging with pools and funds where relationships are not developing as hoped, as well as indirectly by actioning the Board's Good Governance recommendations from 2021.

In some cases, it seems that the Department does accept the Board's perspective of governance rather than size being key, for example in relation to the recognition by officials that the Wales Pension Partnership will be seen as an exception to the general rule and not expected to achieve the "optimal" scale of £50bn. This recognises that particular, strong partnership arrangements already in place for Wales and its unique national identity (including the need to produce materials in the Welsh language).

The Board feels that the consultation proposals should also recognise that there are potential risks associated with size including concentration risk (particularly in London) and the loss of ability to be nimble and take advantage of smaller opportunities. Genuinely local

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place-based investments are likely to be in the latter category. Generally, though there are likely to be different “sweet spots” in terms of scale for different asset classes. That seems to be recognised by the reference in the consultation to certain pools specialising in particular asset classes, rather than each pool developing that expertise separately.

### **Question 2: Do you agree with the proposal to set a deadline in guidance requiring administering authorities to transition listed assets to their LGPS pool by March 2025?**

The Board understands the importance of setting clear deadlines but believes that March 2025 is an unrealistic deadline for all funds to transfer all listed assets. The Board would like to see evidence that the date has been chosen with due regard to the need to balance the associated tax and transition costs with the perceived benefits.

Key to the reasonableness of any target is how exacting the test will be of the reasons for not transferring an asset and the administrative burden of demonstrating this. It would be helpful to have further detail from DLUHC on what is expected to be contained in the “detailed rationale” for not transferring an asset, as well as who – whether those with fiduciary responsibility for investment, or DLUHC officials – would judge whether the rationale was adequate and how it is envisaged to be reported.

We also believe that an exception for the deadline should be made for the passive investment assets held via insurance funds. This is because the larger insurance funds already offer greater scale (and hence lower fees) than pools would be able to offer through any authorised contractual scheme of their own.

We would also welcome confirmation that an acceptable reason for delaying transition exists for legacy illiquid assets, particularly those in private markets, where the fee terms are already fixed. Transferring these assets to the pool would not allow for those fees to be revisited but would simply incur new legal, transition and tax costs.

The Board would suggest that the most appropriate point in the triennial valuation cycle for funds to be considering relevant factors and consulting on their investment and funding strategy statements would be one year later, in 2026. By then, the 2025 valuation results will be known and can be taken into account.

As a point of principle, the Board does not accept that it would be an appropriate use of the direction-making power contained in Regulation 8 of the LGPS Investment Regulations 2016 to compel a fund to transfer ownership of an asset to a pool, or disinvest from a non-pooled asset in order to invest in a pooled one, unless there was clear evidence that retaining the pooled asset would be a breach of that fund’s fiduciary duty.

In [Hansard](#), when Parliament was considering this power, the then Minister Marcus Jones MP was clear that:

“It is important to point out that that is an example of a backstop provision. The intention is to use this backstop provision sparingly and only when it is necessary to step in to protect the interests of both the scheme members and the local taxpayers, who might have to step in and bail out the LGPS if the investments are not made in a way that provides the best return from those funds.”

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The Board does not believe that LGPS funds are simply refusing to transfer assets where there is a clear financial benefit in transferring it to a pool. It is also not clear how the Department could from a distance make the necessary detailed financial assessment that this was the case. The Board would also query whether Stamp Duty would be payable on any transfer that happens by virtue of a legal direction given by the Secretary of State. Generally speaking it is not chargeable on assets transferred by operation of law.

The Board feels it is more appropriate for Government to focus on increasing the active participation of funds in pools (and thereby the pool's effectiveness) rather than using the threat of direction to compel funds to act against a fund's own better judgement.

### **Question 3: Should government revise guidance so as to set out fully how funds and pools should interact, and promote a model of pooling which includes the characteristics described above?**

It is not clear what is meant by "promotion" of a particular model in this context. Government doesn't have the ability to direct or even issue guidance to pools that they would have to have regard to. The Board also believes that there are limits to how far guidance issued under Regulation 7 of the LGPS Investment Regulations 2016 could be used to indirectly shape pool governance arrangements.

The Government does have the ability to amend the 2016 Regulations or issue statutory guidance under them, but exactly what that would say and whether it would require unwinding of existing arrangements is not clear. The consultation recognises that different models have been adopted and says that "each model has its own benefits", which suggests that the model of pooling will remain heterogeneous rather than homogenous. If that is not Government's view, then it should explicitly state that and outline its preferred operating model for the pools that it sees existing in the longer term.

The Board also feels while the Department's preferred model of pooling can work, it may not be the most appropriate approach for all funds. The picture drawn in the consultation is of a relatively top-down structure: with the Secretary of State potentially giving directions, pools having ownership of most decisions and partner funds left with quite residual functions. We believe that perspective needs to be altered to a more collaborative model, which has proved successful in practice. In this approach, funds are recognised as having a strong and active role in the governance of pools. They are able to hold the pool, its Board and executives to account and there is an important role for member representatives in that too.

The consultation says that there will be guidance on member representation but does not give any indication of what this would say. The Board believes that such guidance should recognise that member representatives will have an interest in "following the money" and ensuring that value is achieved at every stage. It should be clear that member representatives' role is to provide oversight – and they should be able to participate in the governance of the pool.

The Department also needs to seriously consider how the messages in this consultation could negatively affect progress with pooling. If there is a prospect of some pools ceasing to exist in the near future, then that will give many funds occasion to pause transfers and reconsider their participation in that particular pool. This is precisely the opposite effect to what it is trying to achieve.

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If the number of pools is to reduce, the Minister needs to carefully balance any further marginal gains through increased scale against what may prove a greater cost of disruption (in terms of managing pool staff and buildings, fees, stamp duty and diversion of management attention at both funds and pools). There is no indication in the consultation of how this process of rationalisation is expected to occur nor what the respective roles of Government, pools and funds would be in that process. Without clear ground-rules for how mergers or acquisitions would work, the risk is that they become time-consuming and messy, and therefore costly.

There is also a potential issue where the pool is an adviser on investment strategy as well as provider of products. There are potential conflicts of interest there that need to be considered, with appropriate protections put in place where necessary.

### **Question 4: Should guidance include a requirement for administering authorities to have a training policy for pensions committee members and to report against the policy?**

The Board very much welcomes this recognition of the importance of training for Pension Committee members, with the need for Committee members' training to be "levelled up" to at least equal the responsibility placed in primary legislation and regulations on Pension Board members. We share the desire for increased transparency on effectiveness of outcomes and training of Pension Committee members and think that the proposals are the absolute minimum that should be expected, particularly bearing in mind the requirements of the MIFIDII opt up.

The Board would welcome a commitment from the Department to work with it to develop within a defined timescale a consistent set of reporting standards for training (and if agreed trusts that the Minister will approve the budget necessary to support this work). We would also encourage the Department to set out a long-awaited timetable for the implementation of the full range of [Good Governance recommendations](#) on training and expertise that were sent to the (then) Minister two and a half years ago and are yet to be addressed.

Indeed, in relation to these proposals we would urge the Department to go further and require those sitting on Pension Committees to meet standards which more closely mirror the statutory requirements on Pension Board members. They are expected to develop a knowledge and understanding of the law relating to pensions, the rules of the scheme and basic principles relating to the funding and the investment of scheme assets. There is no reason why Pension Committee members should not have a similar legal obligation, and this would also address the current anomaly whereby Pension Board members are required to demonstrate that they have the capacity to fulfil their roles but there is no similar provision in respect of Pension Committee members.

The consultation document proposes to require funds to report on the training undertaken. However, the current statutory guidance (issued by CIPFA in 2019) already says that the Governance Compliance Statement should include "membership of each panel, board, committee or sub-committee with a matrix showing each member's voting rights, record of attendance at meetings and details of training received during the reporting period".

The same statutory guidance also recommends that the Annual Report includes "details of training offered and take-up (training is mandatory for local pension board members but not for a pensions committee)". As per our introductory remarks, there is a need for a more

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effective mechanism to ensure compliance, but this should be combined with a thorough revision of the range of reporting duties which funds are expected to comply with.

### **Question 5: Do you agree with the proposals regarding reporting? Should there be an additional requirement for funds to report net returns for each asset class against a consistent benchmark, and if so how should this requirement operate?**

The Board has long believed in the need to increase the quality and transparency of reporting by funds. As mentioned in the response to Question 4, the Board believes that there should be a detailed review of the relative functions and content of the SF3 return, the Annual Report (AR) and other reporting duties on LGPS funds and pools.

It makes sense to review these in a holistic way, especially as further new reporting obligations (such as around climate risk reporting) are in development. For each source (AR, SF3, pool reporting) we need to be clear about the intended audience, purpose and what conclusions readers are meant to be able to draw from the data. Of course, in carrying out this review we need to be mindful to minimise the administrative burden that arise from any changes made.

The Board agrees that it would be helpful to have better and more consistent data on investment performance. We support the principle that data on net returns should be reported against appropriate benchmarks. However, there are practical difficulties in doing so and the choice of benchmark would be significant and needs to be carefully considered – the Board would welcome engagement about how this might work.

The Board would also emphasise that this data will need to be presented with sufficient contextualisation. Without that, comparing net return figures between funds could lead to erroneous conclusions being drawn if the reader were not sufficiently aware of how the figure would be affected by considerations such as the different funding positions, different risk appetites (which will be reflected both in strategic asset allocation and the choice of assets within a specific asset class) and the extent to which the assets are managed in-house or externally.

### **Question 6: Do you agree with the proposals for the Scheme Annual Report?**

Yes, this will be helpful and make it easier to produce the Board's annual Scheme Report. It will however require an up-front investment of time and resource which we will reflect in the Board's workplan, and budget, for coming years.

The Board would also like to remind the Department of its [proposal](#) to separate the production of pension fund annual accounts in England from the administering authorities' own accounts, as is already the case for the LGPS in Scotland and Wales. This policy measure would help to significantly improve the quality and timeliness of Scheme-level data.

### **Question 7: Do you agree with the proposed definition of levelling up investments?**

We understand the temptation, with borrowing costs for Government at a higher level than they have been for some time, to look to LGPS funds as a ready source of funding for regeneration or infrastructure projects. And there is no question that more needs to be done to boost productivity, grow the economy, raise living standards and to do so in a way that

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reduces the inequality in outcomes across the UK. However, LGPS funds cannot invest simply to support Government policy or provide loans on favourable terms for projects supported by Government.

However, the Board believes that most funds are very open to investing in place-based initiatives where particular projects can be demonstrated to be consistent with the fund's fiduciary duty and appetite for risk. Due to the need to manage conflicts of interest, we again urge the Department to implement the recommendations of the Board's Good Governance review, which includes the need for each fund to have a conflict of interest policy. Not least because local authorities and other scheme employers (e.g. universities and housing associations) may well be partners in some of the proposals which the fund is invited to support.

Some funds have a deep understanding about how their local economy works, which could give them a competitive advantage over other investors. But the key barriers are scale and supply of opportunities: we would like to see a deeper consideration by Government of what can be done collectively to address those.

For funds to invest, the bar to be passed for "levelling up" investments is a relative one, set by the opportunities presented elsewhere in the economy (and a global economy at that). UK infrastructure projects will need to be competitive with other opportunities around the world.

We note that the consultation says that the LGPS "can play a key role in building a pipeline of investable UK opportunities without costly deal by deal auctions". The most appropriate role for LGPS funds in this context is likely to provide a clear steer to Government on the kinds of propositions (in terms of risk, cost and return) that it would be interested in, the range of those between different funds and eventually to invest in suitable opportunities. While LGPS funds should be consulted on what the pipeline is for and who the potential customers of that pipeline are, we do not believe that it would be for the LGPS to construct it. That is clearly a job for a Central Government agency (or a body nominated to act on its behalf).

We believe that Central Government absolutely needs to take a more active role in this space and could do so by setting out a clearer and more activist industrial strategy, or make a comparable offer to support transition to a net zero world such as those offered in other jurisdictions (like the significant funding commitments announced by the US and EU).

In relation to the specific question on the definition of Levelling Up investments, that proposed at paragraph 62 of the consultation document does seem to have the necessary degree of flexibility. There are ongoing debates on the best way to measure impact and no settled methodology has yet emerged. We would expect the requirement that the impact be "measurable" not to be tested against any particular standard. Indeed, some of the levelling up missions themselves are very loosely described and so we would also not expect the Department to quibble about whether any particular investment did or did not meet the definition – that is best left for local determination.

### **Question 8: Do you agree that funds should be able to invest through their own pool in another pool's investment vehicle?**

We are not aware of anything that would prevent a fund from investing in another pool if that pool had opened its funds to external investors. As far as we are aware, no pools have taken



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that step and for good reason (these are very clearly set out in the response from SYPA, which has been shared with the Board). GLIL does allow the admission of new investors outside the LGPS but GLIL is not a pool as such, but rather a cross-pool (LPP and Northern) investment vehicle. Increased use of collaborative vehicles of that type may be a more productive route for the Department to explore rather than permitting or encouraging funds to invest via pools other than their own “home” pool. There is also the potential for additional costs to arise as a result of investing in another pool’s product through the “home” pool, which would seem to run counter to the cost-saving aims of pooling.

### **Question 9: Do you agree with the proposed requirements for the levelling up plan to be published by funds?**

The Board has no objections in principle to the publication of a levelling up plan by funds, so long as the requirements are proportionate, in line with fiduciary duty and integrated with the other duties and strategies that funds need to produce. The detail of this should be wrapped up in the general review that we have proposed of what information LGPS funds are required to publish.

As was mentioned in the answer to Question 7 above, the Board would also like to see the Department, and HM Treasury, produce a plan for how it will help increase the scale and investable opportunities available to LGPS funds.

### **Question 10: Do you agree with the proposed reporting requirements on levelling up investments?**

At the risk of repetition, the Board has no objections to LGPS funds being asked to report on how they are investing in line with a Levelling up target. However, any requirement needs to be proportionate and considered alongside a review of publication duties more generally.

It should also be acknowledged that Levelling Up investments are not an asset class of their own. We would therefore suggest that the investments are to be reported under the principal asset class breakdown. These kinds of investments may come in terms of public or private equity, and also take the form of bonds (like those issued by water utility companies).

### **Question 11: Do you agree that funds should have an ambition to invest 10% of their funds into private equity as part of a diversified but ambitious investment portfolio? Are there barriers to investment in growth equity and venture capital for the LGPS which could be removed?**

The Board does not agree with this proposal. We feel the increasing attempts by the Government to intervene in asset allocations is unhelpful. Asset allocation is the key determinant of success and requires careful consideration of the specific circumstances of the fund and is based on taking professional advice from officers, actuaries, investment consultants and others. Statements from Ministers cheerleading particular asset classes, albeit well meant, are not relevant or particularly helpful to that process.

In any case many funds are now in a position where, due to strong funding levels and the desire of many employers to manage volatility in their future contribution levels, they wish to reduce their exposure to risk. That makes them very reluctant to increase their allocation to riskier asset classes, such as private equity.

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It would also be helpful to clarify whether this is intended to cover private markets and growth assets more generally. We believe it makes less sense to limit it to private equity, narrowly defined.

The Government should also be aware that, putting aside considerations of risk and return, there are issues with transparency working with some private equity managers. That is both in terms of cost transparency data and climate risk reporting.

The Board would also put forward the suggestion that private debt be considered to be part of this ambition – should it be pursued by Government. Private debt often provides funding to UK companies as they grow and develop, and therefore could be said to meet the Government's desire to contribute to overall UK economic growth.

### **Question 12: Do you agree that LGPS should be supported to collaborate with the British Business Bank and to capitalise on the Bank's expertise?**

The Board believes that Government departments and agencies like the UK Infrastructure Bank and British Business Bank should work together to pull together a pipeline of investable opportunities for LGPS funds. The Board has previously recommended that the Government create and market a selection of social impact bonds. As different funds and pools are of markedly different sizes, the creation of bonds would allow all funds to invest at a scale that is appropriate for them.

Central Government clearly has a role to play here. For example, we look to the Government to develop a coherent and well understood industrial and planning strategy that gives long-term investors confidence that this is more than a passing political fad.

Longer term policy commitments, and ideally cross-party consensus, would be extremely helpful to address the policy risk that accompanies the financial risk in many larger projects. As we have seen with debates on HS2, airport expansion and on-shore wind, uncertainty around how Government policies may change is damaging to investor confidence.

To create some certainty and sense of momentum, some governments have identified significant streams of funding to support transition towards Net Zero, e.g. those announced in the United States and the European Union.

### **Question 13: Do you agree with the proposed implementation of the Order through amendments to the 2016 Regulations and guidance?**

Yes

### **Question 14: Do you agree with the proposed amendment to the definition of investments?**

Yes

### **Question 15: Do you consider that there are any particular groups with protected characteristics who would either benefit or be disadvantaged by any of the proposals? If so please provide relevant data or evidence.**

The Board believes that it is important for the financial services industry to become more inclusive and that Government and the LGPS should consider how its practices can further that aim. The Board notes that the development of pooling companies has enabled the

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LGPS to bring in more diverse talent and create opportunities and viable career paths in parts of the country where this was not the case before. Notable examples include the way Border To Coast has brought new jobs to Leeds and made it the biggest investment player in the UK not based in London or Edinburgh. Similar success is evident in Wolverhampton, due to LGPS Central, which has been [actively championing](#) the need for change in the investment industry.